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MATERIALS ON

PERSONAL INCOME SECURITY LAW

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for

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Chapter II: Unemployment Insurance

This chapter provides an introduction to one of the currently more controversial income-maintenance schemes. While not attempting to cover the substantive law in detail, the materials do aim to raise several of the issues which we will be dealing with throughout the course.

How does an insurance-oriented system differ from welfare? Why should it matter? The first set of papers present the technical debate. While reading these you might keep in mind the underlying, though unspoken, elements of public and political acceptability. (See, for example, the passage from Britain preceding his analysis of the payroll tax.) Also at issue is the ongoing federal-provincial conflict over welfare reform. The provinces are quick to resist what they view to be encroachments on their jurisdiction through the back door.

Who should receive unemployment compensation? A common sense definition of unemployment might include all individuals currently looking for work. If the plan is welfare-based, only those in need should collect. Can this system justify payments to the unemployed family member who still has access to a spouse's or parent's income? On the other hand, an insurance scheme may only cover those who have paid their premiums. If you have contributed regularly, does the government now have a contractual obligation to provide support?

Who should be responsible for paying compensation? Presumably someone is at fault. If unemployment benefits are restricted to the "involuntary unemployed", perhaps the employers are to blame. Are they equally to blame or should those with more frequent layoff patterns pay a greater share? Do companies really have a choice or are their decisions dictated by the capitalist market system? For example, at times government stabilization policy may be designed to maintain a high level of unemployment.

Who in fact does bear the costs? Does the levying of a payroll tax on employers mean they pay their share? Or are they able to shift the burden onto consumers in the form of higher prices and workers by limiting wage increases?

One of the major problems in program design is adverse incentive effects. For example, in stipulating eligibility criteria you induce those otherwise excluded to conform to the requirements, if the payoff

is sufficiently high. Thus a short prior-work demand may tempt some to enter the labour force in order to qualify for benefits. High ratios of benefits to past wages may prove preferable to work, with its high costs in terms of foregone leisure. Requiring employers with unstable employment histories to pay higher premiums may hurt small industry and encourage private policing of workers' claims. On the other hand, equalizing payments subsidizes their wage bill with funds collected from stable industries and provides no incentive to change. The issues are numerous and complex.

Several cases have been included in the chapter. You should test your understanding of the materials by analysing the possible incentive and distributional effects of the decisions.

NOTE: a) Many of the articles presented are American. The Canadian system is very different and the differences should be noted.

b) Technical passages have been included in several articles to preserve continuity. In general, they are not necessary to understand the arguments.

Welfare or Insurance?

Bank of Montreal (1974)

Canada's Unemployment Insurance

The idea that the state should sponsor an insurance scheme to protect those who have been involuntarily thrust into the ranks of the unemployed is a recent one. In the Nineteenth Century, unemployment was generally regarded as an individual or personal responsibility, and not one with which society or the state should interfere, no matter the degree of hardship entailed.

The alarming level of unemployment which accompanied the Depression years of the 1930's, and new ideas about the role of government in such a situation propounded by the British economist, John Maynard Keynes, served to create a new approach which saw unemployment insurance, not only as a humanitarian endeavour, but also as an "automatic stabilizer" of economic activity.

Although Canadian proposals for a scheme of unemployment insurance were first enunciated as early as 1919, it was not until 1935 that the federal government introduced concrete legislation in this area. The Unemployment and Social Insurance Act of 1935, however, was to have a short life-span, for in 1937, it was declared unconstitutional. However, after achieving a rare degree of unanimity with all of the Provinces, the federal government had the B.N.A Act amended, and in 1940, a new Unemployment Insurance Act was passed providing Canada with a permanent plan of assistance for the unemployed.

Although the broad essentials embodied in the original 1935 legislation have been maintained to the present day, Canada has faced the usual problem of finding a middle ground for supporting a system which, while not denying assistance for those sincerely seeking employment opportunities, was also not subject to abuse from those who would wish to view the Plan as an alternative to gainful employment.

The Plan, originally administered by the Unemployment Insurance Commission, was compulsory for all employed persons, except for those engaged in certain specified employments, such as private domestics, stevedores, teachers and police, and anyone earning in excess of $2,000 a year. The self-employed were also excluded. Contributions to the Plan came from three sources: the employer, the insured employee, and the government. Eligibility commenced after five days (originally nine) of proven unemployment, i.e., that the claimant was, in fact, unemployed, capable of and available for work, and unable to find suitable employment. Under certain circumstances, such as refusal of suitable employment, loss of employment through misconduct and so forth, the claimant was disqualified.

Many minor adjustments were made to the original Act, but it was not until 1955 that significantly more liberal provisions were introduced, mainly because the Fund was growing to embarrassingly high levels. (It reached $900,000,000 by December 1956.) The liberalization of the Act, however, was soon to transform the surplus into an equally awkward deficit, especially beginning in the Spring of 1963.

In fact, easier benefit provisions, the extension of coverage to groups of workers formerly excluded, and the relaxation of rules regarding the payment of benefits to a claimant while in receipt of other payments such as special allowances, severance and

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Chapter III: WELFARE PROGRAMMES

The primary concern in this chapter is welfare and the problems of the poor. If benefits are not distributed according to past contributions, as in insurance schemes, how is eligibility to be determined? What issues does the means test raise?

Work incentives are again examined; however the focus is not on the income-leisure decision which was touched on earlier in the discussion of unemployment insurance. Here, the structure of benefit systems is analysed to show how efforts to supplement income are taxed. The problems of overlapping and linked program coverage are also introduced.

Throughout these readings, it is important to realize that many of the positions taken depend on an underlying premise that work is socially more valuable than the income it generates. For example, the debate on the efficiency of daycare may not ultimately be resolved without tackling the problem of the role work should play in a welfare system. Should efforts be directed at encouraging work? Or, is it more desirable that children receive full time parental attention? What if the cost to the government of daycare is greater than the recipient-parent can earn by working steadily at the minimum wage? Does work provide some additional therapeutic returns?

The growth in welfare disbursements is directly related to an increase in family instability. Some analysts, remarking on the noticeable lack of aid to working, poor families, have claimed that the existing forms of relief have furnished additional incentives to dissolve family units. A wife, whose husband has left her, can receive government aid to care for her children. A girl with an illegitimate child, will likewise be eligible so long as she remains unmarried. The traditional administrative responses such as requiring the deserted wife to sue her husband, disqualifying the unwed mother if there is a "man in the house", raiding homes at midnight to determine if the husband has really left, etc. only serve to exacerbate any problems which may exist. Although the lawyer is confronted with the conflict between civil rights and protection of the system from abuse, the economist may be able to reveal how the law provides the perverse behavioural incentives.

The issues of distributional adequacy and equity are examined more closely with an introduction to the problems in designing an appropriate accounting system. To illustrate, suppose X has a job which requires that he works only six months of the year at a wage of $100 per month; Y works twelve months of the year and earns $50 dollars per month. If the accounting period is monthly, X may be entitled to benefits for all months in which he receives zero income - even though his annual labour income is the same as that of Y. If an annual accounting period is chosen, neither can receive aid. But, suppose Y loses his job for two months in the middle of the year. Must he wait until the end of the year to collect his benefits?

Other issues are left to the reader to extract from the various cases and summaries of eligibility criteria. For example, how should wealth, as distinguished from income, be treated? Problems in selecting the appropriate filing unit (i.e. whether the program should look at the individual, his immediate family, or all his relatives in determining available income and needs) are postponed until the discussion of the negative income tax proposals.

The arguments about the efficiency of cash versus in-kind benefits surface once again. This time the housing and medical care markets are examined. Market analyses, such as these, can provide insight into problems such as determining the best ways to give relief, e.g. urban renewal or rent vouchers. Market imperfections can even be used to justify state provision of medical insurance.

Vertical equity was briefly mentioned in the chapter on unemployment insurance. With respect to that program, there are many indications that a large proportion of those collecting may be secondary earners from middle-income families. This problem may also be present in many in-kind programs. Stigler's article attempts an explanation.